
FRBSF WEEKLY LETTER

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Difficult Times for Japanese Agencies and Branches

During the second half of the 1980s, the Japanese economy prospered. A rise in the Japanese stock market added to the so-called hidden reserves of Japanese financial institutions, giving them an abundance of capital. As Japanese individuals and institutions invested heavily in the U.S., Japanese banks built a major presence here, increasing their market share substantially. This was notably true in California, where Japanese banks have long been active.

The sustained decline in the Japanese stock market that began in late 1989 severely affected the capital of Japanese banks. As growth in the Japanese and U.S. economies faltered, Japanese banks also faced increasingly serious asset quality problems, especially in their real estate loan portfolios. This *Letter* examines the rapid expansion of Japanese-owned banking institutions in the United States since 1985 and analyzes the impact of problems in real estate markets on the condition of Japanese-owned banking institutions, with an emphasis on California.

Rapid growth

In the late 1980s, the growth of Japanese banking institutions in the U.S. was dramatic. Between 1985 and the peak in 1990, Japanese-owned banking institutions' assets rose from \$180 billion to almost \$436 billion, and their market share of U.S. banking assets nearly doubled, from 6.5 percent to 11.8 percent. The change in market share was even more striking in California, where Japanese institutions went from 16 percent of the market in 1985 to 27.5 percent at the end of 1990.

The totals for Japanese banks in the United States reflect two distinct groups of Japanese-owned banking institutions: (1) agencies and branches and (2) subsidiaries. A branch of a foreign bank has full banking powers and can accept deposits;

an agency of a foreign bank offers limited banking services, and cannot accept domestic deposits. At year-end 1992, Japanese-owned banks operated 121 agencies and branches in the U.S. with combined assets of over \$344 billion, about 85 percent of the U.S. total for Japanese banking institutions; 32 of these agencies and branches were in California, with combined assets of \$59 billion. (Most of the others were in New York.) These entities traditionally have been oriented toward wholesale banking, including trade-financing and money-market services, so they are relative newcomers to real estate lending in the United States. Unlike commercial banks, which generally make a mix of both commercial and residential loans, the real estate loans of foreign agencies and branches are almost all for commercial real estate or construction.

Subsidiaries of Japanese banks are U.S. banks, chartered and regulated by U.S. banking agencies, but at least 25 percent owned by a Japanese bank. At year-end 1992 Japanese banks had 21 U.S. subsidiaries with assets of \$63 billion. Japanese subsidiaries are generally full service banks, offering a wide array of wholesale and retail banking services, including residential and commercial real estate loans, consumer loans and middle market business loans. Nowhere is this more true than in California, where the combined assets of the ten Japanese-owned subsidiaries were about \$40 billion at the end of 1992, and four of them ranked among the state's ten largest commercial banks. Many of these subsidiary banks have long been active real estate lenders, mostly for residential rather than commercial mortgages.

Between 1985 and 1991, real estate lending in the U.S. surged, especially for Japanese-owned agencies and branches: For U.S. domestic banks real

WESTERN BANKING

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estate loans doubled; for Japanese-owned subsidiaries they quadrupled, peaking at \$18.4 billion; and for Japanese-owned agencies and branches, which lent largely for commercial real estate, they rose from \$250 million to \$40.5 billion, about one-ninth of the total assets of these offices. This activity resulted in a tremendous shift in market share in the United States. Japanese-owned banking institutions held only 1 percent of outstanding bank real estate loans in the United States in 1985. In six years that figure went to 6.7 percent.

Part of the surge in real estate lending may have been related to the well-documented rise in Japanese investment in U.S. real estate. Foreign customers often prefer dealing with a bank rooted in their home country, because they have established customer relationships with these banks and are familiar with the language, customs, and banking practices. The bulk of Japanese real estate investment was in office buildings and hotels, corresponding to the rise in real estate lending by the agencies and branches with their traditional commercial orientation.

Loan problems

As the Japanese banking institutions added to their real estate portfolios, many U.S. real estate markets began to show signs of stress. These market developments are reflected in the loan portfolios of the Japanese institutions, particularly the agencies and branches. A customary measure of problem loans is the ratio of nonaccrual loans plus loans 30 day or more past due divided by total loans of that type outstanding. Over the last two years the aggregate problem real estate loan ratio for California banks has risen from 5.8 percent to 8.5 percent, reflecting the market downturn. The trend of problem loan ratios at Japanese-owned subsidiaries in California has been similar, although the level has been higher.

The pattern of problem loans at Japanese agencies and branches has differed notably. Problem real estate loan ratios rose much more sharply, from 2.3 percent at the beginning of 1991 to 9.4 percent at the end of 1992. Such a change was significant, since real estate loans were about one-third of the total lending of these agencies and branches. The problems have not been limited to California; Japanese agencies

and branches in New York fared even worse. Like California, real estate markets in New York have been hit hard since 1990. At year-end 1992, the problem real estate loan ratio for Japanese agencies and branches in New York stood at 15.5 percent.

Thus, Japanese agencies and branches have paid a heavy price for their recent deep involvement in real estate. The deterioration in loan portfolios has affected the profitability of Japanese operations in California, where the California State Banking Department tracks income for state-licensed agencies and branches. Although income figures for individual offices should be interpreted with caution, the state data show that many Japanese offices lost money in 1992; the 23 state-licensed Japanese agencies and branches had a weighted-average return on assets (ROA) of -0.45 percent for the year. In contrast, California banks as a whole posted an average ROA of 0.58 percent despite facing similar market conditions.

What next?

Japanese banks have been hit hard by economic conditions. At home, real estate woes and a sluggish economy put pressure on parent banks. Similar problems in California, and in the nation as a whole, took a further toll. The difficulties have been particularly pronounced at Japanese agencies and branches, the group that recorded the most rapid increases in commercial real estate lending after 1985. They faced high levels of problem loans, reduced property and collateral values, and commercial real estate markets with clouded prospects for near-term recovery.

Japanese banks have taken significant steps to recover from these recent difficulties, through write-offs, loan loss provisions, and additions to capital; they currently meet relevant international capital standards. The most recently available data also suggest the beginning of a shrinkage by Japanese agencies and branches in California. In view of the prominent role they have played in California lending in recent years, a sustained cutback would be a significant change of the banking tides.

Gary C. Zimmerman
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REGIONAL BANK DATA
JUNE 30, 1993
 (NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

		DISTRICT	ALASKA	ARIZ	CALIF.	HAWAII	IDAHO	NEVADA	OREGON	UTAH	WASH.
ASSETS AND LIABILITIES - \$ MILLION (ALL COMMERCIAL BANKS)											
ASSETS	TOTAL	494,793	5,017	36,000	323,995	22,173	10,426	18,638	25,739	14,405	40,401
	FOREIGN	30,008	1	0	27,751	2,176	0	0	0	61	20
	DOMESTIC	464,785	5,017	36,000	296,244	19,998	10,426	18,638	25,739	14,344	40,380
LOANS	TOTAL	327,592	2,544	20,242	217,625	13,848	7,208	9,610	17,917	8,464	30,136
	FOREIGN	28,756	5	0	27,315	1,418	0	0	0	0	18
	DOMESTIC	298,836	2,538	20,242	190,310	12,430	7,208	9,610	17,917	8,464	30,118
	REAL ESTATE	157,525	1,232	7,482	112,475	7,373	2,287	2,374	7,612	3,686	13,026
	COMMERCIAL	61,558	793	2,666	38,402	3,117	1,562	793	4,589	1,633	8,004
	CONSUMER	53,674	372	6,453	24,382	1,070	2,181	8,259	3,680	2,414	6,855
	AGRICULTURAL	5,830	4	314	2,979	41	781	13	431	158	1,108
	INTERNATIONAL	125	0	8	116	0	0	0	0	0	1
SECURITIES	TOTAL	77,372	1,914	9,314	42,725	5,208	1,902	4,320	4,335	3,437	4,216
	U.S. TREASURIES	24,367	877	2,836	12,212	2,740	447	1,673	1,377	787	1,418
	U.S. AGENCIES	40,172	567	5,394	24,174	1,954	782	2,160	2,138	1,649	1,354
	OTHER SEC.	12,834	470	1,084	6,340	514	673	488	820	1,001	1,444
LIABILITIES	TOTAL	451,189	4,372	32,486	296,692	20,477	9,848	14,286	23,458	13,134	36,637
	DOMESTIC	421,181	4,372	32,486	268,942	18,301	9,848	14,286	23,458	13,073	36,616
DEPOSITS	TOTAL	396,085	3,582	29,447	268,472	14,280	7,847	9,796	20,587	10,814	33,260
	FOREIGN	27,508	1	0	25,486	1,893	0	0	0	61	68
	DOMESTIC	368,577	3,582	29,447	240,987	12,387	7,847	9,796	20,587	10,753	33,192
	DEMAND	94,889	1,094	6,577	65,490	2,434	1,493	2,663	4,375	2,484	8,280
	NOW	40,598	329	3,297	23,971	1,462	1,004	1,330	3,265	1,488	4,452
	MMDA & SAVINGS	138,727	1,213	10,877	92,927	4,967	2,609	3,953	6,679	3,512	11,898
	SMALL TIME	65,259	434	7,259	37,657	2,039	2,166	1,006	5,371	2,567	6,761
	LARGE TIME	28,798	476	1,436	20,749	1,481	575	839	889	701	1,652
OTHER BORROWINGS		32,741	753	2,533	12,485	5,325	1,599	3,398	2,201	1,976	2,470
EQUITY CAPITAL		43,602	645	3,514	27,302	1,896	778	2,352	2,281	1,270	3,764
LOAN LOSS RESERVE		10,054	42	555	7,365	238	110	483	448	200	613
LOAN COMMITMENTS		194,960	605	29,553	107,803	7,001	3,203	12,656	11,257	6,657	16,224
LOANS SOLD		17,651	32	144	16,758	139	24	100	223	63	170
TIER1 CAPITAL RATIO		0.098	0.211	0.137	0.089	0.103	0.097	0.169	0.102	0.130	0.093
TOTAL CAPITAL RATIO		0.127	0.223	0.152	0.124	0.123	0.113	0.183	0.120	0.147	0.116
LEVERAGE RATIO		0.079	0.129	0.084	0.075	0.071	0.072	0.130	0.081	0.090	0.082
EARNINGS AND RETURNS - \$ MILLION (ALL COMMERCIAL BANKS)											
INCOME	TOTAL	11,000	107	724	6,886	431	221	765	631	309	927
	INTEREST	8,324	88	568	5,276	365	186	430	456	243	711
	FEES & CHARGES	754	6	57	501	12	15	17	48	22	75
EXPENSES	TOTAL	8,839	75	594	5,729	327	182	570	476	234	670
	INTEREST	2,631	24	183	1,663	145	69	100	138	84	223
	SALARIES	2,293	25	156	1,573	87	31	51	137	54	179
	LOAN LOSS PROVISION	797	3	12	582	18	6	130	18	6	23
	OTHER	3,118	23	244	1,911	77	56	288	183	90	245
TAXES		886	10	57	529	37	20	67	55	26	85
NET INCOME		1,308	22	96	640	67	39	125	100	49	171
ROA (% ANNUALIZED)		1.07	1.76	1.08	0.80	1.20	1.51	3.18	1.57	1.40	1.71
ROE (% ANNUALIZED)		12.00	13.46	10.93	9.37	15.72	20.16	21.23	17.56	15.38	18.14
NET INTEREST MARGIN (% ANNUALIZED)		4.66	5.18	4.34	4.50	3.96	4.50	8.39	4.98	4.53	4.89
ASSET QUALITY - PERCENT OF LOANS (LARGE COMMERCIAL BANKS)											
LOAN LOSS RESERVE		3.17	1.59	2.75	3.50	1.71	1.50	5.27	2.60	2.34	2.13
NET CHARGE-OFFS, TOTAL		1.07	0.08	0.31	1.24	0.58	0.20	4.91	0.42	-0.29	0.33
REAL ESTATE		0.94	-0.09	0.17	1.28	0.10	0.09	1.04	0.13	0.00	0.08
COMMERCIAL		0.72	-0.02	-3.15	1.11	1.64	-0.07	-1.11	-0.02	-1.66	0.11
CONSUMER		2.81	0.29	1.91	3.11	0.81	0.51	6.90	1.55	0.72	1.10
AGRICULTURAL		-0.05	0.00	0.98	-0.55	2.28	0.32	-0.04	0.78	0.09	0.40
PAST DUE & NON-ACCRUAL, TOTAL		4.89	2.59	3.83	5.77	2.82	1.76	6.65	2.18	2.24	2.89
REAL ESTATE		6.58	2.69	6.05	7.66	2.89	2.25	8.19	2.60	2.99	3.85
CONSTRUCTION		18.34	1.10	17.31	21.05	10.55	5.64	22.96	6.87	5.83	13.18
COMMERCIAL		7.00	4.10	10.94	8.30	1.68	3.37	6.11	3.54	4.23	2.11
FARM		7.71	0.00	17.88	8.38	9.04	1.82	0.00	5.21	14.05	2.44
HOME EQUITY LINES		1.11	1.30	0.56	1.15	1.01	0.45	0.77	1.37	0.54	2.00
MORTGAGES		3.19	1.38	2.26	3.82	2.65	1.13	3.72	0.97	1.07	1.18
MULTI-FAMILY		7.59	0.80	10.36	9.26	1.34	0.00	28.32	0.16	0.81	1.32
COMMERCIAL		4.56	2.47	5.71	5.14	3.65	1.49	10.29	1.80	2.30	2.89
CONSUMER		2.97	2.34	2.44	3.23	2.39	1.39	5.97	1.37	1.30	1.56
AGRICULTURAL		3.93	0.00	5.35	4.30	19.05	2.15	1.73	4.90	2.42	2.76
NUMBER OF BANKS		728	8	36	440	17	20	19	47	49	90
NUMBER OF EMPLOYEES		243,000	2,759	19,228	156,953	8,788	4,667	6,290	16,284	7,414	20,617

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MARKET SHARE STATISTICS																														
DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS																														
PERCENT OF COMBINED MARKET TOTAL FOR AUGUST 1993, BY REGION																														
	DISTRICT			ALASKA			ARIZONA			CALIF			HAWAII			IDAHO			NEVADA			OREGON			UTAH			WASH		
DEPOSIT TYPE	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU	CB	SL	CU
TOTAL DEPOSITS	55	38	7	72	4	24	92	1	7	48	46	6	65	29	5	91	5	3	77	20	3	81	10	9	79	6	16	56	34	9
DEMAND	90	6	4	99	0	1	96	0	4	89	7	4	91	4	6	96	0	4	97	3	0	95	1	4	89	5	6	85	13	2
NOW	64	28	8	60	6	35	89	0	11	58	36	7	66	31	3	92	4	4	79	15	6	84	8	9	83	2	16	66	23	11
SAVINGS & MMDAS	61	30	9	56	4	40	90	0	10	57	36	7	59	34	7	92	4	4	79	16	5	77	10	14	73	3	24	56	27	17
SMALL TIME	31	65	4	75	8	17	95	1	4	22	74	3	53	45	2	88	11	1	46	51	3	77	17	6	80	12	8	39	56	5
LARGE TIME	43	46	10	95	1	3	91	1	8	36	52	12	74	19	8	90	6	4	86	14	0	72	14	14	67	12	21	43	54	2
CB = COMMERCIAL BANKS; SL = SAVINGS & LOANS AND SAVING BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING																														

INTEREST RATES ON DEPOSITS AND LOANS										
TYPE OF RETAIL DEPOSIT ACCOUNT OR LOAN		AUG 1991	NOV 1991	FEB 1992	MAY 1992	AUG 1992	NOV 1992	FEB 1993	MAY 1993	AUG 1993
SAVINGS ACCOUNTS AND MMDAS	U.S.	5.12	4.64	3.78	3.57	3.14	2.90	2.80	2.65	2.55
	DISTRICT	5.25	4.68	3.81	3.67	3.29	3.05	2.96	2.78	2.67
92 TO 182 DAYS CERTIFICATES	U.S.	5.61	4.89	4.00	3.82	3.36	3.14	3.08	2.98	2.96
	DISTRICT	5.57	4.76	3.85	3.76	3.34	3.14	3.01	2.88	2.85
2-1/2 YEARS AND OVER CERTIFICATES	U.S.	6.79	6.02	5.36	5.45	4.87	4.70	4.59	4.45	4.40
	DISTRICT	6.53	5.71	5.03	5.17	4.75	4.49	4.41	4.27	4.19
COMMERCIAL SHORT TERM FIXED	U.S.	7.13	6.09	5.18	4.87	4.42	4.17	4.16	3.91	4.02
	DISTRICT	7.33	7.01	6.50	6.26	4.86	5.35	5.21	4.84	4.78
COMMERCIAL SHORT TERM FLOATING	U.S.	8.62	7.83	6.47	6.56	5.95	5.91	5.85	5.58	5.53
	DISTRICT	8.03	9.08	7.66	7.34	8.37	7.23	8.26	8.09	8.54
COMMERCIAL LONG TERM FIXED	U.S.	8.53	7.82	6.33	7.27	6.28	5.97	6.43	6.02	6.21
	DISTRICT	10.20	10.10	7.70	8.68	8.28	6.44	9.19	10.86	8.05
COMMERCIAL LONG TERM FLOATING	U.S.	9.47	8.14	6.95	7.06	6.60	6.53	6.38	6.47	6.05
	DISTRICT	9.60	8.89	8.10	7.38	7.63	8.11	8.43	8.55	8.77
CONSUMER, AUTOMOBILE	U.S.	11.06	10.61	9.89	9.52	9.15	8.60	8.57	8.17	7.98
	DISTRICT	N/A	10.80	9.90	9.67	9.39	8.76	8.98	8.23	8.09
CONSUMER, PERSONAL	U.S.	15.24	14.88	14.39	14.28	13.94	13.55	13.57	12.00	13.45
	DISTRICT	N/A	13.59	13.64	13.80	13.68	12.83	12.67	13.87	12.69
CONSUMER, CREDIT CARD	U.S.	18.24	18.19	18.09	17.97	17.66	17.38	17.26	17.15	16.59
	DISTRICT	N/A	18.41	18.51	18.52	18.46	18.29	17.76	17.60	17.58

SOURCES: MONTHLY SURVEY OF SELECTED DEPOSITS, SURVEY OF TERMS OF BANK LENDING, AND TERMS OF CONSUMER CREDIT
MOST COMMON INTEREST RATES ON RETAIL DEPOSITS, WEIGHTED AVERAGE INTEREST RATE ON LOANS. ANNUAL RATES.